In the Supreme Court of the United States

OCTOBER TERM, 1978

NO. 78-687

THE LOUISIANA LAND AND EXPLORATION COMPANY,
PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION
and
THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
RESPONDENTS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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CITATIONS

CASES (Continued)

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The Louisiana Land and Exploration Company ("Land Company") petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

Opinions Below

The opinion of the court of appeals (App. A, *infra*, pp. 1a-9a) is reported at 574 F.2d 204. The opinion denying rehearing (App. B., *infra*, p. 10a) is not yet reported. The initial opinion and order (No. 772) of the Federal Power Commission (App. D, *infra*, pp. 13a-27a), and its opinion and order (No. 772-A) denying rehearing (App. E, *infra*, pp. 28a-39a) are not officially reported.

Jurisdiction

The judgment of the court of appeals was entered on May 30, 1978 (App. C, *infra*, pp. 11a-12a). Land Company's application for rehearing (and its alternative conditional application for leave to adduce additional evidence) was denied on September 11, 1978 (App. B, *infra*, p. 10a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1) and Section 19(b) of the Natural Gas Act, as amended, 15 U.S.C. § 717r(b).

Questions Presented

1. Whether a lessor-royalty owner, under an oil and gas lease, who owns no gas and has no gas to sell, makes a "sale in natural gas for resale" and thus becomes a "natural gas company" subject to regulation under the Natural Gas Act as a result of (a) consenting to a sublease by the lessee to an interstate pipeline company, and (b) agreeing, at the pipeline's request, to accept settlement for gas royalties on the basis of a specified number of cents per Mcf rather than on the fluctuating "market value" provided for in the lease.

2. Whether this Court's decision in *Rayne Field* [1] requires that the ordinary and usual meaning of the word "sale" in the Natural Gas Act be abandoned in favor of a single test of "economic effect."

3. Whether, accepting *arguendo* the application of the "economic effect" theory, there is any substantial evidence to support the implicit finding of the court of appeals that

1. *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965).

Land Company exercised power to determine the incidents of a sale of gas in interstate commerce by its lessee.

4. Whether the court of appeals erred in denying, and acted arbitrarily in denying without stating any reason for such denial, Land Company's application under Section 19 (b) of the Natural Gas Act for leave to adduce additional evidence where Land Company had made the statutory showing that such evidence was material (and would eliminate any refunds), and that such evidence did not become available until after the oral argument in the court of appeals.

Statutes Involved

Section 1(b) of the Natural Gas Act, as amended, 15 U.S.C. § 717(b), provides:

> "The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

Sections 2(6), 7(c), 7(e) and 19(b) of the Natural Gas Act, as amended, 15 U.S.C. §§ 717a(6), 717f(c), 717f(e) and 717r(b), which are also involved, are set forth in Appendix F, *infra*, pp. 40a-44a.

Statement

Land Company, a landowner, in 1954 (prior to *Phillips*)[2] granted an option to a predecessor of Amoco Production Company ("Amoco") to acquire an oil and gas lease covering lands in Plaquemines Parish, Louisiana, in what later came to be known as the Bastian Bay Field. Amoco exercised the option and acquired a lease in 1955. (Two other leases on the same lease form were also acquired, but, for simplification, only the first is discussed.) Amoco drilled upon the leased premises and discovered gas and condensate. After additional drilling had confirmed substantial reserves, Amoco wished to make what was thought to be (by Amoco) a non-jurisdictional sublease of leases, or "lease sale." Land Company's oil and gas lease required the consent of Land Company to an assignment or sublease of the lease. (The usual conventional gas sales contract could have been made by the lessee *without* Land Company's consent.) Land Company's lease called for gas royalties based on a fraction of the price received by the lessee when sold to a third party, but based on a type of "market value" when the lessee used the gas or sold it to an affiliate. (App. D, *infra*, pp. 14a-15a).

In 1960, Amoco advised Land Company of its proposed sublease to Tennessee Gas Pipeline Company ("Tennessee"). Amoco and Tennessee wished to obtain Land Company's consent to the sublease, and Tennessee wished to obtain relief from the "market value" aspect of the gas royalty clause because, as lessee, it would be taking gas for its own use. Tennessee suggested that, in lieu of "market value," Land Company's royalties be calculated on a flat amount; initially, 22.5¢ per Mcf, escalating to 25¢ per Mcf at January 1,

2. *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

1962. Land Company agreed to consent to the sublease (or "lease sale") and to amend the gas royalty provision as requested, and this was embodied in a letter dated July 15, 1960. (Exh. 42, R. 2725, *et seq.*) (App. D, *infra*, pp. 15a-16a).

In 1967, the Federal Power Commission ("the Commission," now Federal Energy Regulatory Commission) commenced a "show cause" proceeding against Land Company (and others) to require Land Company to obtain a certificate of public convenience and necessity under Section 7 of the Natural Gas Act, charging that Land Company had elected to take "its gas" in kind, and was selling same to Tennessee in interstate commerce. Land Company contested the show cause proceeding and the "show cause" was consolidated with the massive Amoco-Tennessee dockets resulting from this Court's reversal in *Bastian Bay*[3] (on the basis of *Rayne Field*[4]) of the decision of the court of appeals for the Tenth Circuit which had held the "lease sale" non-jurisdictional.[5]

While this *Bastian Bay* proceeding was crawling its way before the Commission, a proceeding entitled *Denman v. J. M. Huber Corporation*, FPC Docket Nos. RI67-113, *et al.*, in which the question of the right of the Commission to regulate royalty owners in general was at issue, was being litigated. In the instant case, in 1968 a presiding Administrative Law Judge of the Commission upheld Commission

3. *Federal Power Commission v. Pan American Petroleum Corp.*, 381 U.S. 762 (1965).

4. *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965).

5. *Pan American Petroleum Corp. v. Federal Power Commission*, 339 F.2d 694 (CA 10 1964).

jurisdiction over Land Company on the basis of an initial decision by another Administrative Law Judge in *Denman*, issued several months before. Land Company filed exceptions to the initial decision (as did other parties) and the Commission on December 23, 1971, remanded the proceedings for the purpose of further hearings.[6] The remanded proceedings were intended to produce evidence as to whether the transaction between Amoco and Tennessee should be conventionalized "so that the producer and the purchaser bear the cost burdens which they would in a conventional sale." [7] This remand order issued less than one week after the decision on review of the *Denman* dockets, holding that royalty owners generally were not subject to Commission jurisdiction, had been handed down in *Mobil*.[8]

At the remanded proceedings, extensive evidence was offered by the principle parties and the Commission's staff with a view to "conventionalization" of the "lease sale" agreement. Land Company, subject to its jurisdictional objection, introduced evidence on the construction of an assumed "contract" for the royalty owners. Finally, the principle parties agreed to a settlement, and, over Land Company's objection, the royalty dockets were severed, and additional briefing was provided for on the jurisdictional issue and on the issue of liability for refunds.[9] This resulted, eventually, in the Commission's Opinions 772 (App. D,

6. *Tennessee Gas Pipeline, et al.*, 50 FPC 1194 (1973).

7. *Tennessee Gas Pipeline, et al., supra*, n. 6.

8. *Mobil Oil Corp. v. Federal Power Commission*, 463 F.2d 256 (CA DC 1971), *cert. den.* 406 U.S. 976.

9. *Tennessee Gas Pipeline, et al., supra*, n. 6.

infra, pp. 13a-27a) on August 6, 1976, and 772-A(on rehearing) (App. E, *infra*, pp. 38a-39a) on December 13, 1976, asserting jurisdiction over Land Company and ordering refunds.

Land Company sought review in the court of appeals for the Fifth Circuit, which resulted in that court's decision of May 30, 1978 (App. A, pp. 1a-9a). Land Company timely (June 13, 1978) petitioned for rehearing and combined with its petition an alternative conditional application for leave to adduce additional evidence pursuant to Section 19(b) of the Natural Gas Act. On September 11, 1978, the court of appeals denied rehearing and denied Land Company's alternative motion, *per curiam* (App. B, p. 10a).

Reasons for Granting the Writ

This case presents a jurisdictional issue of substantial importance to the administration of the Natural Gas Act, as amended, 15 U.S.C. § 717 *et seq.*, respecting (a) the meaning of the word "sale" as used in the Act, (b) the effect of a consent to a transfer of an oil and gas lease by a lessor, and (c) the effect of an agreement by a royalty owner to accept royalties calculated on a fixed amount rather than "market value." Unless overturned, the ruling of the court of appeals will make it difficult, if not impossible, for interstate natural gas pipelines to acquire oil and gas leases from landowners directly, or to obtain consents to lease transfers in their favor, and, at the same time, will make it difficult, if not impossible, to obtain agreement from royalty owners to settle on a fixed amount per Mcf rather than "market

value." [10] The decision of the court of appeals overstates the effect of this Court's decision in *Rayne Field*, so as effectively to amend judicially the plain meaning of "sale," and, while paying lip service to *Mobil*, effectually rejects *Mobil's* holding, creating a conflict in principle with the District of Columbia Circuit.

Additionally, and beyond the errors of law above shown, the judgment below was plainly wrong. The court of appeals, *contrary* to all the evidence in the record, and without *any* evidentiary basis, has based its holding on an innuendo (not even a finding) that Land Company exercised its rights under the oil and gas lease in some unexplained manner so as to coerce Tennessee into paying a "higher" royalty rate, and thus "controlled" the incidents of a jurisdictional sale.

Finally, and of importance to the judicial administration of the Natural Gas Act and of sound judicial procedure generally, the court of appeals denied, and failed to give any explanation of its denial, a motion to adduce additional evidence which complied in terms with Section 19(b) of the Act.

Items 1 and 2 in "Questions Presented," *supra*, are so intertwined that they will be discussed together. The other items will be treated separately.

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10. The Commission's Brief to this Court in *Federal Energy Regulatory Commission v. Pennzoil Producing Company, et al.*, No. 77-648, points out the undesirable effects, from a regulatory standpoint, of fluctuating "market value" royalties. From the royalty owner's standpoint, the prospect of regulation by the Commission in any respect is not viewed with equanimity.

1. A. This case is a sequel to *Mobil Oil Corporation v. Federal Power Commission*, 463 F.2d 256 (CA DC 1971), cert. den. 406 U.S. 976. There the Commission had found that it had jurisdiction over royalty owners as a class. The Commission there argued that, in economic effect, a royalty owner who had retained rights to receive money royalties on gas in the mineral lease transaction made a sale of gas in interstate commerce when the gas produced was sold by the lessee to an interstate pipeline and the royalty owner received royalty payments on the gas so sold. The Commission relied upon this Court's decision in *Rayne Field, supra*, as its authority for this argument, as well as for the proposition that the ordinary meaning of the word "sale" in the Act could be disregarded. The Commission pleaded the asserted necessity of regulating royalty payments in order to afford the "complete, permanent, and effective" protection to the consumer mandated by this Court.[11] The court of appeals, however, held that it was the congressional intent that the word "sale" in the Act was to be accorded its ordinary meaning and that, generally, the royalty owner was not considered to be engaged in any "sale" of gas. The court of appeals carefully considered the effect of *Rayne Field* on the Commission's "economic effect" argument and emphasized that there was no question of "sale" involved in *Rayne Field*--only of whether the admitted sale was of leases or of gas. The court explained that neither the mineral lease nor the receipt of royalties under the lease constituted a "sale" contemplated by the Act. The court ". . .put to one side any special case of a landowner who takes a share of the gas pro-

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11. See *Atlantic Refining Co. v. Public Service Comm'n of New York*, 360 U.S. 378, 388 (1959). The court of appeals, nevertheless, pointed out that the Commission was already protecting the consumer through area rates (463 F. 2d at pp. 263-265).

duced as his royalty and resells it" (463 F.2d at p. 260, n. 10).[12] This Court denied certiorari.

Here, the Commission, supported by the court of appeals, has sought to squeeze a typical lessor-lessee transaction through the strait gate of *Mobil* (*i.e.*, taking gas in kind and selling it) by charging that in "economic effect" a sale was made. Land Company had executed an oil and gas lease on its usual form which, under *Mobil's* teaching, did not constitute an element of a sale of gas.[13] It had reserved royalties on gas, payable in money, and reserved no right to take gas in kind as royalty; again, no indication of a "sale." Its lessee, Amoco, owned and had the full right, without control by Land Company, to dispose of 100% of the gas produced from the leased premises. Under *Mobil*, Land Company's receipt of gas royalties would not have been a "sale" of gas. If Amoco, the lessee, had made the customary conventional sale of gas, there would have been no question that Amoco's sale was jurisdictional and that Land Company's royalties were non-jurisdictional, whether based on the legislative meaning of "sale" or on "economic realities."

12. In *Mobil* the court of appeals reserved decision on certain special circumstances found in the "Denman 'R' Lease," where the landowner would not grant the lease until after an interstate gas sales contract had been signed. The court remanded this issue (of whether the royalty owner had so participated in the sale as to render his royalties jurisdictional) to the Commission for decision. On remand, the Commission denied jurisdiction stating: "Denman as a royalty owner had no title to the gas under the lease agreement, and thus no gas to sell." This decision was not appealed. See Order Denying Petition, issued June 26, 1973, in *William Harvey Denman, Trustee, et al. v. J. M. Huber Corporation,* FPC Docket Nos. RI67-113, et al., 49 FPC 1143.

13. Mr. Justice Stevens, dissenting, in *State of California, et al. v. Southland Royalty Company, et al.,* 98 S.Ct. 1955, 1966 (1978), found in *Mobil* ". . .the rule that the royalty provisions of an oil and gas lease are not subject to the Natural Gas Act." (56 L.Ed.2d 505, 520).

Only because Amoco wished to make a "lease sale" instead of a "gas sale" was Land Company's consent to transfer required, and this consent was given. Because the transferee did not wish to be subject to the uncertainty resulting from a "market value" type gas royalty clause, it requested Land Company to accept gas royalty settlements on a fixed cents per Mcf basis (22.5¢ per Mcf until January 1, 1962, and 25¢ per Mcf thereafter). Land Company agreed. The consent to a transfer of leases is not a departure from the usual oil and gas lessor-lessee relationship. And the agreement to peg "market value" at a fixed or readily ascertainable figure is a frequent occurrence in natural gas division orders. In short, Land Company did nothing that, under *Mobil*, amounted to a "sale." It ". . . as a royalty owner had no title to the gas under the lease agreement and had no gas to sell." (*Denman, supra,* n. 12.) Land Company, literally, exercised no control over the lease sale by Amoco to Tennessee, nor over ". . . any incident of such sale either as to the quantity to be sold, the price to be paid, the identity of the purchaser or whether it shall be sold in interstate or intrastate commerce." (*Mobil, supra,* 463 F.2d at p. 262.)

The court of appeals here disregarded the holding of *Mobil* that "sale" was to have its normal meaning-- equating this to a "label"-- and stated that "economic realities and not labels determine whether a jurisdictional sale has occurred" (App. A, p. 5a). The court then detailed the "economic realities" as (a) the retention of the right to receive gas royalty payments; (b) the right to grant or withhold consent to a sublease or assignment (both of which the court then acknowledged *not* to amount to a "sale"); (c) the exercise of the "power to withhold consent" by *granting* consent; (d) the necessity of this consent to permit Amoco to accomplish a

jurisdictional lease sale; and (e) the acceptance by Land Company of the pipeline's suggested payment basis for royalties in lieu of "market value."

The opinion implies that these so-called "economic realities" are the equivalent of the elements of a sale of gas in interstate commerce. But this proposition does not bear analysis. In any "sale" there must be an intent to transfer, an agreed price, and a thing to transfer.[14] *Amoco's* transaction fulfilled these three essentials because there was an expressed intent to transfer, an agreed sales price, and a "thing," which, although in form a lease, was in truth a supply of natural gas. *Land Company's* actions, on the contrary, show *no* intent to transfer, *no* agreement on a "sales price" (only on a determination of the amount of "rent"),[15] and *no* "thing" to sell because Land Company, literally, had nothing to sell. The court's opinion, instead of piercing form to reach reality, is piercing reality to construct a pseudo-jurisdictional form.

B. In avoiding a "mechanical" interpretation of the Act (App. A, p. 4a), the court of appeals completely ignored the ordinary meaning of the word "sale"-- thus conflicting in principle with *Mobil*. The court of appeals also misread the effect of this Court's decision in *Rayne Field.*[16] *Rayne Field* held that a sale of oil and gas leases under the conditions there pertaining was a sale of natural gas, in economic effect,

14. *Butler v. Thomson,* 92 U.S. 412, 414 (1876); *cf.* Art. 2439, *La. Civil Code*: ". . . Three circumstances concur to the perfection of the contract [of sale], to-wit: the thing sold, the price and the consent."

15. La. R.S. 31:123: ". . . royalties paid to the lessor on production are rent."

16. *United Gas Improvement Co. v. Continental Oil Co.,* 381 U.S. 392 (1965).

and therefore a "sale" under the Act. While the Court cautioned that "technical concepts of local law" should not be permitted to hamstring the federal regulatory statute (381 U.S. at p. 400), it did *not* say that the ordinary meaning of statutory language should be totally disregarded. In *Rayne Field* the parties had agreed upon a conventional gas sales contract, unquestionably subject to FPC jurisdiction, when a change in regulatory pricing (dictated by the decision in *CATCO*[17]), caused them to change the form of their agreement from a sale of gas to a sale of leases, without changing the economic effect. Land Company here did no such thing, but acted as a "lessor" throughout.

If *Rayne Field* is to be accorded the effect attributed to it by the court of appeals, this Court should consider reshaping its holding so as not to require the disregard of the plain meaning of the statute.[18]

17. *Atlantic Refining Co. v. Public Service Comm'n of New York,* 360 U.S. 378 (1959).

18. *Rayne Field* (381 U.S. at 400-401) relied on two cases to support its use of "economic realities" instead of the usual meaning of words: *NLRB v. Hearst Publications,* 322 U.S. 111 (1944), and *Gray v. Powell,* 314 U.S. 402 (1941).

In *NLRB v. Hearst Publications,* the Labor Board found that newsboys who, under common law tests, were independent contractors, were "employees" under the National Labor Relations Act. This Court affirmed the Board's position that the usual definitions of "employee" could be disregarded and held that the meaning was to be determined by "underlying economic facts" (322 U.S. at p. 129). Congress "reversed," "holding" that the word "employee" was used in its usual sense and that Congress did not intend the Labor Board to give "far-fetched meanings" (*i.e.,* "underlying economic facts") "but ordinary meanings" to the statutory language. This history is set forth in *NLRB v. Steinberg,* 182 F.2d 850 (CA 5 1950), particularly at pp. 854-855, n. 11.

(Footnote 18 - continued on next page).

2. The holding of the court of appeals is expressed in the following language:

> "We hold that [a] by retaining a royalty interest in gas extracted from premises leased to Amoco, [b] retaining power to prevent Amoco from selling its entire interest in proven and developed reserves to a pipeline company, and [c] agreeing to an amendment of the terms of the royalty payments *before consenting to the jurisdictional transfer,* Land made a jurisdictional sale of natural gas." (Emphasis and literation added.)

This holding is supported neither by the record nor by the law. Item [a] is not an incident of a "sale" under *Mobil.* Additionally, the statement is in error since under the lease there is no retained "interest in gas" -- only a right to money royalties. Item [b] is not *alone* sufficient to constitute a sale (as the opinion admits), and is misdirected since Land Company retained no right to prevent the sale of the entire reserves by the usual gas sales agreement. Item [c] is couched in misleading language: the implication of the emphasized words is that Land Company insisted on the royalty provision amendment as a condition to its consent to transfer. This implication is without any support in the record; indeed, it is contrary to all evidence in the record. Without the implication, and with amendments to conform to the record, the express holding should have read:

(Footnote 18 - continued)

Rayne Field's reliance on *Gray v. Powell* is also misplaced. The "pertinent" facts referred to in *Gray v. Powell* had to do with the question of whether a punitive tax was to apply to coal produced by an independent contractor from a railroad's captive mine and taken by the railroad for its own use. The tax applied to coal "sold or otherwise disposed of." The Court reasoned that the words "otherwise disposed of" meant something beside a "sale" and the economic circumstances were recited, not to support a "sale," but an "other" disposition.

> "We hold that [a] by retaining the right to receive royalty payments on gas extracted from premises leased to Amoco, [b] retaining power to prevent Amoco from selling proven and developed leases to a pipeline company (but not power to prevent a sale of gas), and [c] agreeing, at the request of the pipeline, to an amendment of the terms of the royalty payment, Land [Company] made a jurisdictional sale of natural gas."

If the opinion's holding were so corrected, it is, on its face, in direct conceptual conflict with *Mobil.*

The lack of evidentiary support for the holding of the court of appeals is demonstrable within the confines of this petition. The genesis of the opinion's implication lies in similar innuendo in Opinion No. 772 (App. D, p. 19a) where the Commission said that Land Company ". . . had only agreed to the transaction at a specific price higher than for the lease-sale gas based on direct negotiations." Land Company's application for rehearing [19] pointed out that this was not the fact; that ". . . the specification of a dollar value was not sought by Land Company but by Tennessee, for its own purposes." Opinion No. 772-A (App. E, p. 34a) did not meet the issue directly, but responded with a quotation from the record to show that, if Land Company ". . . did not like the assignment to Tennessee, or the terms of it, it *could* refuse to give its assent." (Emphasis added.)

19. R. 2983, 2997; App. Ct. App. 335, 349. References herein to "App. Ct. App." refer to the Appendix filed by Land Company in the court of appeals.

The record on this subject consists of the document in which Land Company *consented*,[20] and of the testimony of two witnesses, Land Company's Vice President, Mr. Langhetee, and Amoco's (adverse) witness, Mr. Renfro. Mr. Langhetee stated that Tennessee had proposed the lease amendment as to the gas royalty calculation because ". . . Tennessee felt that it was necessary from their standpoint that our leases be amended so as to substitute a fixed dollar value on which royalties on gas would be calculated, rather than the bases provided by our mineral leases which might result in fluctuating values."[21] At a meeting with Amoco and Tennessee, Land Company offered to consent to the transfer and to agree on the figures presented by Tennessee as a basis for [initial] royalty settlement, but wished to retain the benefit of the "market value" provisions.[22] Tennessee insisted, however, and Land Company agreed.[23]

Amoco's witness, Mr. Renfro, testified, on cross-examination by Commission Staff Counsel, that Land Company took no part in the negotiation of the lease sale;[24] expressed no preference "concerning the type of the lease sale or who would purchase the gas, or the terms of the lease sale agreement";[25] and that the fact that Land Company's "consent to transfer the leases" did not "affect in any way any of the

20. Exh. 42, R. 2725, *et seq.*, App. Ct.App. 218, *et seq.*

21. R. 372; App. Ct.App. 39.

22. R. 376; App. Ct.App. 42 (App. E, pp. 31a-32a).

23. *Id.*

24. R. 1030-1031; App. Ct.App. 77 (App. H, *infra*, p. 47a).

25. R. 1032; App. Ct.App. 78 (App. H, p. 47a).

terms of the lease sale contract."[26]

There is, thus, absolutely no evidence in this record from which a fair inference might be drawn that Land Company used its power to withhold consent to a lease transfer as a means of exacting "higher"[27] royalty calculations. Indeed, the opinion of the court of appeals contains no specific record reference to support this implicit holding; nor did Opinion No. 772 nor Opinion No. 772-A. The reason for the omission, obviously, is the lack of record support.

There are here no "economic realities" constituting a "sale" by Land Company. It *is* an "economic reality"[28] that the sale by Amoco to Tennessee was, in reality, a sale of gas, not of leases. It is an undeniable fact that this sale was of all of the gas, not of just a portion. In other words, economically, the lease sale was equivalent to a conventional gas sales contract. Let us insert this "reality" into the factual context here and observe its operation. The scenario would read:

"Amoco, wishing to make a conventional gas sales contract with Tennessee, approaches Land Company and asks for Land Company's consent to the gas sales contract. Land Company points out that its consent is not required under the lease to sell gas, but Amoco insists because it fears that the gas sales contract might constitute a transfer under the

26. R. 1032-1033; App. Ct.App. 79 (App. H, p. 48a).

27. If Land Company's proferred evidence is received, it will show "lower" instead of "higher" calculations resulted.

28. Because this Court has so held. *Federal Power Commission v. Pan American Petroleum Corp.*, 381 U.S. 762 (1965).

lease. Not wanting to create any problem for its lessee, Land Company consents. Tennessee says it, too, needs help. Since it will not be selling the gas at or near the field, it can not pay royalties based on sales proceeds, but must, under the lease terms, calculate them on a fluctuating 'market value,' and that this creates too much uncertainty to support its financing. Would Land Company agree to accept royalties calculated at 22.5¢ and later 25¢ per Mcf? Land Company doesn't care for the idea, but, not wishing to impede its lessee's contract, agrees."

Put in this context, Land Company makes no "sale" by consenting that Amoco enter into a contract to sell all of the gas to Tennessee, an interstate pipeline. Land Company makes no sale when it agrees to accept money royalties calculated on a specified cents per Mcf any more than any other royalty owner signing a division order.

Yet if the sale of gas by Amoco is the economic reality which accomplished the dedication of all of the gas to interstate commerce, it is not a matter of mere "labels," but of fact, to say that in "economic reality" Land Company made no sale, intended no sale, and had no gas to sell.

3. Land Company, in connection with its petition to the court of appeals for rehearing of its decision of May 30, 1978, filed an alternative conditional application for leave to adduce additional evidence.[29] Land Company showed that the hearings before the Administrative Law Judge were concluded in 1973, and that the refund calculations provided for

29. That portion of Land Company's petition for rehearing containing its application for leave to adduce additional evidence is reproduced as Appendix G, *infra,* pp. 45a-46a, without attaching the supporting affidavit.

by Opinion No. 772 in 1976 were based on production through the year 1971. Opinion No. 772 assumed, as did the parties, that refunds so calculated would continue to increase. However, from calculations made in 1978 (after the oral argument herein) on the basis of 1977 production figures not theretofore available, negative "refunds" existed due to the operation of the take-or-pay clause prescribed by the Commission in Opinion No. 772. Land Company attached to its application an affidavit of a person competent to testify showing the calculations that resulted in no refunds being due.

The court of appeals denied the application without explanation for its denial.

Section 19(b) of the Natural Gas Act (15 U.S.C. § 717r (b)) (App. F, pp. 40a-44a) expressly provides for the receipt of such evidence. The requirements of the statute are that the additional evidence is "material," and that there were "reasonable grounds" for failure to adduce the evidence before the Commission. Here, the evidence was obviously "material"; it changed an order for refunds of some $1,600,000 into no refunds, thus requiring a reversal of ordering paragraphs (C) and (D) of Opinion No. 772. It was not available "before the Commission" because its existence was not known until after the argument in the court of appeals.

Under such circumstances, the court of appeals should have granted the application and retained jurisdiction to revise its judgment if the evidence adduced before the Commission so warranted. At the least, the court of appeals should have explained the basis of its denial so that a reviewing court need not speculate as to its reasons, just as the

court of appeals would have required the Commission to explain a similar action. *Cf. Louisiana Power & Light Co. v. Federal Power Commission*, 526 F.2d 898, 904 (CA 5 1976); and *cf. Burlington Truck Lines v. United States*, 371 U.S. 156, 167-172 (1962).

This is a matter of grave prejudice to Land Company. Final affirmance of the Commission's refund order may well be the equivalent of an order of execution of judgment. Yet the evidence proferred shows conclusively that no refunds are due.

Conclusion

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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October, 1978

APPENDIX A

Opinion of United States Court of Appeals, Fifth Circuit

The LOUISIANA LAND AND EXPLORATION COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

No. 76-4380.

United States Court of Appeals, Fifth Circuit.

May 30, 1978

Petition for Review of an Order of the Federal Energy Regulatory Commission.

Before BROWN, Chief Judge, GODBOLD and RONEY, Circuit Judges.

GODBOLD, Circuit Judge:

Louisiana Land and Exploration Company (Land) petitions for review of an order of the Federal Energy Regulatory Commission (FERC).[1] We must decide whether FERC erred in determining that Land made a sale of natural gas subject to FERC jurisdiction and in requiring Land to pay re-

1. FERC is the successor agency to the Federal Power Commission (FPC).

funds. We find no error in the FERC jurisdictional conclusion and nothing unreasonable, arbitrary or abusive of discretion in the refund order. Accordingly, we affirm.

Land leased mineral rights in its property to a predecessor of Amoco Production Company (Amoco), a gas producer. The lease required Amoco to pay Land a gas royalty measured by a percentage (either 27½% or 30%)of the value of the gas produced. The lease defined the value of gas produced to be either the price at which Amoco sold the gas or, if Amoco produced but did not sell the gas, the fair and reasonable value of the gas as reflected in part in the highest selling price of similar gas. The lease prohibited assignment, sublease or other transfer of leasehold rights without Land's prior written consent.

In an effort to sell all its rights in the lease, Amoco negotiated with Tennessee Gas Pipeline Company, a pipeline company. After Amoco and Tennessee reached tentative agreement, but before Land had approved the transaction, Tennessee approached Land and offered to purchase Land's royalty rights in the lease. Tennessee offered alternatively to amend the lease so as to measure royalties at a fixed rate (severance taxes plus 22.5¢ and later 25.0¢) per thousand cubic feet of gas removed from the leased premises rather than a rate that varied with the selling price of the gas. Land declined to sell its royalty interest but accepted the fixed rate amendment and consented to the transfer of leasehold rights from Amoco to Tennessee. The arrangement was embodied in a letter contract drafted by Land and signed by Land, Amoco and Tennessee.

Following the transfer of leasehold rights from Amoco

to Tennessee,[2] FERC directed Land to respond to the question whether Land's participation in the transfer of the lease and subsequent receipt of renegotiated royalties constituted the sale of gas in interstate commerce subject to FERC jurisdiction and whether, if the arrangement constituted a jurisdictional sale, Land should obtain certificates of public convenience and necessity authorizing and regulating the sale.[3] Having considered Land's responses to the questions, FERC reasoned that "[t]he result . . . that Amoco is selling part of the gas to Tennessee for 21 cents per Mcf while Land . . . is receiving 25 cents for another part of the gas . . . economically is a sale" and concluded that "the kind of transaction here developed between Land . . . and Tennessee does not represent a royalty transaction but a sale of natural gas in interstate commerce subject to the jurisdiction of the Commission." Opinion No. 772, issued August 6, 1976, at 5, 4. FERC also determined that Land, having made jurisdictional sales of gas to Tennessee, was required to refund the amount by which its receipts under the royalty arrangement exceeded receipts permissible under a conventional and regulated gas sales contract. In Opinion No. 772-a, issued December 13, 1976, FERC denied Land's application for rehearing.

[1] Our function in reviewing the FERC jurisdictional conclusion is to determine whether it is "without adequate

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2. The transfer from Amoco to Tennessee was a sale of natural gas within the jurisdiction of FERC. *FPC v. Pan American Petroleum Corp.*, 381 U.S. 762, 85 S.Ct. 1802, 14 L.Ed.2d 714 (1965).

3. In the subsequent hearings FERC considered not only whether the royalty transactions were jurisdictional sales but also whether the public interest warranted certification of the transfer from Amoco to Tennessee. FERC resolved the certification question in Opinion No. 667, issued October 24, 1973. The question whether the royalty arrangement constituted a jurisdictional sale was severed without objection and scheduled for additional briefing. *Id.*

basis in law." *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 678, 74 S.Ct. 794, 796, 98 L.Ed. 1035, 1045 (1954). The Natural Gas Act applies to "the sale in interstate commerce of natural gas. . . ." 15 U.S.C. §717(b) (1976). Although Land would have us conclude that because it owns no gas it could never have made a sale of gas in interstate commerce, an analysis of relevant authorities leads us to a less mechanical interpretation of the Act.

[2,3] In *United Gas Improvement Co. v. Continental Oil Co.* (Rayne Field), 381 U.S. 392, 85 S.Ct. 1517, 14 L.Ed.2d 466 (1965), the Supreme Court examined the economic effect of a transaction rather than its form and held that sales to an interstate pipeline company of gas leases covering proven and substantially developed reserves to be sold in interstate commerce were sales of gas within the jurisdiction of FERC. The Court rejected the argument that local law, which did not recognize a sale of gas in place, was dispositive. Instead, reasoning that the sale of the leases "had accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States," the Court approved the FERC determination that because the sale of the leases was the economic equivalent of the sale of gas, the sale was within the jurisdiction of the Commission. *Id.* at 401, 85 S.Ct. at 1522, 14 L.Ed.2d at 472. In *Continental Oil Co. v FPC (Ship Shoals)*, 370 F.2d 57 (CA5, 1966), cert. denied, 388 U.S. 910, 87 S.Ct. 2114, 18 L.Ed.2d 1349 (1967), this court delineated the *Rayne Field* three-pronged test of FERC jurisdiction over sales of gas leases:

(1) Is the economic effect of the transfer similar to that of a conventional sale?

(2) Is the subject of the transaction "proven and substantially developed" reserves?

(3) Is the transfer of the reserves for purpose of interstate transmission and resale?

370 F.2d 57, 62. Land did not sell a lease in a transaction that mirrors those in *Rayne Field* and *Ship Shoals*, but the analysis in *Rayne Field* and *Ship Shoals* supports the conclusion that a restrictive definition of "the sale in interstate commerce of natural gas . . ." is inappropriate if it ignores economic realities.

[4] This conclusion draws additional support from the reasoning of the court in *Mobil Oil Corp. v. FPC*, 149 U.S. App. D.C. 310, 463 F.2d 256 (1971), *cert. denied*, 406 U.S. 976, 92 S.Ct. 2409, 32 L.Ed.2d 676 (1972). The court in *Mobil* reversed a FERC order declaring that when a landowner executes an oil and gas lease providing royalties to be measured by proceeds or value of extracted gas, " 'he has contracted to retain an economic interest in interstate sales by the producer,' and 'has joined the other interest owners in such sales and he has become a seller of natural gas.' " *Id.* 149 U.S.App.D.C. at 316, 463 F.2d at 262. In reversing the FERC decision, the court reasoned that an economic interest in the proceeds of a sale, unaccompanied by authority to determine the incidents of the sale, does not make the interest owner a seller within the Natural Gas Act. Thus, the *Mobil* opinion anticipates the facts of this case and supports our conclusion that economic realities and not labels determine whether a jurisdictional sale has occurred.

[5] The economic realities in this case begin with Land's

execution of a lease in which Land retained not only the right to receive royalty payments but also the right to withhold consent to sublease or assignment by Amoco. A lessor's retention of these rights typically is unreleated to the incidents of the usual jurisdictional sale of gas by a producer-lessee. Indeed, the reasoning of *Mobil* suggests that unless Land had retained powers sufficient to determine the incidents of a jurisdictional sale by Amoco, Land would have made no jurisdictional sale at the execution of the lease.[4] Thereafter, however, Land exercised the retained power to withhold consent to Amoco's transfer of leasehold rights to Tennessee. The exercise of this power was an indispensable ingredient in an indisputably jurisdictional transfer.[5] The exercise of this power was essential to accomplishing the transfer of large amounts of natural gas to an interstate pipeline company for resale in other states and also affected an incident of the sale, the buyer's cost. Moreover, the exercise of the power, coupled as it was with an alteration of the royalty rate, had the effect of altering not only the cost of extracting the gas but also the cost of introducing the gas to commerce. Under these circumstances, we conclude that in economic effect Land sold gas in interstate commerce subject to FERC jurisdiction. We hold that by retaining a royalty interest in gas extracted from premises leased to Amoco, retaining power to prevent Amoco from selling its entire interest in proven and developed reserves to a pipeline company, and agreeing to an amendment of the terms of the royalty payments before consenting to the jurisdictional

4. We do not decide whether a lessor's unexercised retention of a power to block sublease or assignment by withholding consent constitutes sufficient incident-determining authority to support the conclusion that the lessor is a jurisdictional seller.

5. *Supra* note 2.

transfer, Land made a jurisdictional sale of natural gas.

[6] Having concluded that we find no error in the jurisdictional conclusion of FERC, we also conclude that the Commission did not err in ordering Land to refund the surplus of amounts received over amounts that would have been received pursuant to a conventional gas sales contract. Land argues that because it does not own gas it cannot sell gas. Thus according to Land, because the Natural Gas Act permits the issuance of certificates only to applicants that are "able and willing properly to do the acts and to perform the service proposed . . .," 15 U.S.C. § 717f(e) (1976), FERC lacks statutory authority to issue a certificate to Land, and hence to require a refund. The circularity of this argument is apparent, and our affirmance of the FERC jurisdictional conclusion is dispositive of it.

[7] Nor do we agree that FERC approval[6] of the transfer of leasehold rights from Amoco to Tennessee prevents further FERC action against Land. Land reasons that because it was a party to the letter contract that accomplished the transfer and because a determination that Land is a jurisdictional seller having a refund obligation will destroy the letter contract approved by the Commission, the Commission lacked power to conduct further proceedings against Land. We need not determine whether the Commission action in this case has any effect on the private contract entered by Land, Amoco and Tennessee. Although Land originally was a party to the proceedings on the Amoco-Tennessee transfer, the Commission severed from those proceedings the issues involving jurisdiction over Land and other royalty owners before issuing an opinion regarding the

6. Opinion No. 667, issued October 24, 1973. See note 2 supra.

Amoco-Tennessee transfer. Land did not object to the severance and cannot claim now that the earlier proceedings precluded further Commission action against Land.

Land protests that it, "of all the royalty owners in the nation," has been singled out for discriminatory treatment. Although Land claims that other similarly situated royalty owners have not been determined jurisdictional sellers or required to pay refunds, we need not address this question. The record reflects that the other royalty owners dismissed from the proceedings below were not similarly situated.

[8] The claim that the Commission failed to consider the equities before issuing the refund order does not withstand scrutiny. Although neither the Land briefs nor the record on appeal identifies the equities that the Commission allegedly failed to consider, the ultimate balance of equitable considerations is committed to the discretion of the Commission. *Gillring Oil Co. v. FERC*, 566 F.2d 1323, 1326 (CA5, 1978). The Commission is required to explore and give due weight to considerations of equity. *Id.* at 1325-26. As the Commission noted in its opinion and order denying rehearing, "the matter of refunds was considered in a full hearing with a large record and it is necessary to arrive at a result that, considering the interests of producers and consumers, is as equitable as possible." We cannot conclude, on the basis of the record, that the Commission failed to consider the equities.

[9] The power of the Commission to effectuate the purposes of the Natural Gas Act by ordering producers to make refunds is well established. *See United Gas Improvement Co. v. Callery Properties*, 382 U.S. 223, 86 S.Ct. 360, 15 L.Ed.2d 284 (1965); *Mesa Petroleum Co. v. FPC*, 441 F.2d 182 (CA5,

1971). In this case the Commission concluded that a determination of the amount to be refunded required a comparison of the amount Land received with the amount Land would have received had it entered a conventional contract for the sale of gas to Tennessee. Toward that determination, experts testified concerning probable terms of a conventional contract. Although the experts disagreed on estimates and assumptions that would have affected the amount received by Land pursuant to a conventional gas sales contract, the Commission's decision to accept the testimony of one expert rather than another represents a reasonable choice well within its administrative expertise. Land's argument that the refund determination lacks substantial evidentiary support is incorrect.

AFFIRMED.

APPENDIX B

Corrected Order Denying Petition for Rehearing

The LOUISIANA LAND AND EXPLORATION COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

No. 76-4380.

United States Court of Appeals,
Fifth Circuit.

Sept. 11, 1978.

Petition for Review of an Order of the Federal Power Commission.

ON PETITION FOR REHEARING

(Opinion May 30, 1978, 5 Cir., 1978, 574 F.2d 204).

Before BROWN, Chief Judge, and GODBOLD and RONEY, Circuit Judges.

BY THE COURT:

The application for rehearing is DENIED, and the alternative motion that we refer the case to the Federal Energy Regulatory Commission for recalculation of the refund obligation is DENIED. The Commission should, however, allow additional hearing on whether refunds should be recalculated as urged in the alternative motion.

APPENDIX C

J U D G M E N T

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1978

No. 76-4380

FERC Nos. 772 and 772-A

THE LOUISIANA LAND AND EXPLORATION COMPANY,
Petitioner,

versus

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Petition for Review of an Order of the Federal Energy Regulatory Commission

Before BROWN, Chief Judge, GODBOLD and RONEY, Circuit Judges.

J U D G M E N T

This cause came to be heard on the petition of Louisiana Land and Exploration Company for review of an order of the Federal Energy Regulatory Commission, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the order of the Federal Energy Regulatory Commission in this cause be, and the same is hereby affirmed;

It is further ordered that petitioner pay to respondent the costs on appeal to be taxed by the Clerk of this Court.

It is further ordered that petitioner pay to intervenor-respondent the costs on appeal to be taxed by the Clerk of this Court.

May 30, 1978

Issued As Mandate:

APPENDIX D

Opinion of Federal Power Commission

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Richard L. Dunham, Chairman;
Don S. Smith, and
John H. Holloman III.

The Delta Development	)	Docket Nos. CI67-1805
Company, Inc.	)	
Moise W. Dennery	)	CI67-1806
Charles William Fasterling	)	CI67-1807
Gertrude Jackman Fasterling	)	CI67-1808
John Bernard Fasterling, III	)	CI67-1809
The Louisiana Land and	)	
Exploration Company	)	CI67-1810
Joseph McCloskey	)	CI67-1811
Joan B. Fasterling Meyers	)	CI67-1812
Edith Fasterling McGee and	)	
Kenneth C. McGee	)	CI1813

OPINION NO. 772

OPINION AND ORDER DETERMINING JURISDICTION OVER ALLEGED ROYALTY HOLDERS IN LEASE-SALE AND ORDERING FILINGS AND REFUNDS

(Issued August 6, 1976)

Smith, Commissioner:

The question whether the Louisiana Land and Exploration

Company (Land Company), and other alleged royalty owners are subject to the jurisdiction of the Commission as making sales for resale in interstate commerce, and their liability for refunds was severed from the Bastian Bay proceeding by Opinion No. 667 and Order issued October 24, 1973.[1] In Opinion No. 667 the Commission approved a settlement by which Amoco Production Company ("Amoco", including predecessors) was granted a certificate to sell natural gas to Tennessee Gas Pipeline Company (Tennessee) under a proposed lease-sale arrangement from the Bastian Bay Field located onshore in Plaquemines Parish, Louisiana. The proceedings on the severed royalty issue are before the Commission on briefs filed by Land Company, the Public Service Commission of the State of New York and the staff of this Commission.

JURISDICTION

There is no dispute about the facts; rather the dispute is as to their interpretation in the light of applicable law. The principal royalty holder[2] , Land Company, has owned lands in the Bastian Bay Field since the 1920's. In 1938, Land Company granted a royalty interest in certain of the lands to the predecessor of the Delta Development Company, Inc., (Delta).[3] In 1955 and 1959 Land Company executed mineral leases in the Bastian Bay Field to Amoco, including some of the lands in which Delta was granted a royalty interest.

1. *Tennessee Gas Pipeline, et al.*, 50 FPC 1194 (1973), Docket Nos. CI66-269, *et al.*

2. Land Company, Delta and the other lease owners will for clarity be referred to as royalty holders whether or not, as developed below, their interests are those of royalty holoers or sellers of gas.

3. This is stated in an answer filed by Delta on August 11, 1967, to the Commission's show cause order of June 29, 1967.

Under the terms of these leases Amoco obtained the right to produce and dispose of oil, gas and liquids. It was to pay a royalty representing a percentage of the value of the minerals extracted. This value was to be measured, with respect to the gas, by the selling price to third parties, otherwise the fair and reasonable value (Tr. 366-367; Exs. 33, 34, 34-A, 35). It appears that this arrangement would apply to Delta's royalty interest. Land Company acquired a lease from the Fasterlings (Ex. 40) and subleased this to Amoco on December 11, 1959, reserving an overriding royalty interest.

Amoco wished to transfer the leases granted by Land Company, all of which contained a provision requiring consent of Land Company to an assignment (Tr. 369; Exs. 33, 34, 35, Paragraphs 17). In 1959 Amoco's representatives approached Land Company with a proposal to sell the leases for cash and notes to their proposed purchaser, Southern California Edison (Tr. 370-371). Later Land Company was informed that California Edison had withdrawn its offer and that Tennessee Gas Transmission Company was seeking to acquire the leases.

In a letter of March 14, 1960, (Ex. 41), Tennessee offered to purchase Land Company's royalty interest or, alternatively, to amend the leases so as to provide for a royalty in cents per Mcf on the part of the gas subject to royalties. It was explained to Land Company that Tennessee wished a definite value on which to compute the payments rather than an indefinite selling price (Tr. 372-73). It was proposed in the letter that the value of the gas would be 22.5 cents per Mcf from the date of assignment to January 1, 1962, and 25.0 cents per Mcf thereafter. In the letter Tennessee sought opportunity to discuss the proposals with Land Company and offered to send personnel to Land Company's office in

New Orleans to review reserve, development and production matters. Land Company was informed that the gas value figures were substantially the same as the price for other sales in Bastian Bay (Tr. 373-74).

Land Company was unwilling to sell its interest and was fearful of having a pipeline become a lessee because of problems of sufficient takes and drainage. At a meeting held on July 12, 1960, Land Company agreed to Tennessee's figures when Tennessee agreed that the royalty would be paid on the agreed basis whether or not Tennessee would be allowed to recover it as a cost of service (Tr. 376).

The agreement was embodied in a letter contract of July 15, 1960, written by Land Company to Amoco and accepted by Amoco and Tennessee (Ex. 42). In it Tennessee agreed to comply with obligations imposed by the leases to the same extent as if it had been named as an original lessee and to compute and pay royalties as discussed above. On the same day Amoco and Tennessee executed a lease-sale agreement. On December 28, 1960, Tennessee and Amoco entered into an agreement for the same royalty with Delta. Because the other royalty holders, the Fasterlings, et al., granted leases to Land Company (Tr. 358-360) but did not execute agreements with Tennessee the question of Commission jurisdiction here only applies to Land Company and Delta, and the proceedings with respect to the Fasterlings *et al.* will be dismissed.

Land Company argues that since the case was argued before the Commission, the legal situation has been changed by *Mobil Oil Corp.*, v. *F.P.C.*, 463 F.2d 256 (1972), Cert. den. 406 U.S. 976, (1972), holding that a royalty holder does not

make a sale. Further, Land Company cites the testimony of its witness that the letter agreement of July 15, 1960, (Ex. 42) did not constitute a sale under Louisiana law. It contends that the legal result was that Land Company consented to partial transfer and amendment of the leases. It disagrees with staff that Land Company forced Tennessee to negotiate a separate agreement. Finally it says it seems futile to pursue an arguable legal theory by trying to impose Commission jurisdiction on two royalty owners out of millions at this time of gas shortage.

Staff, on the other hand, points out that the two royalty owners utilized their power of approval over the assignment-sale of gas and negotiated a new royalty arrangement with Tennessee, thus, in effect, taking their gas in kind and selling it to Tennessee. It notes that the court in *Mobil* specifically left open the possibility that some types of royalty arrangements would bring the royalty owners under the jurisdiction of the Commission.

Staff makes the further point that the values for gas set forth in the agreement were being measured not against similar returns of other royalty owners, but against other producers, that Land Company separately negotiated for the sale of its royalty portion of the gas, that the word "sale" in the Act must be used in its ordinary and usual sense rather than its meaning under local law, and that the letter of March 14, 1960, sets a value in return for "royalty gas".

The New York Commission argues, in general, that the transaction here is the economic equivalent of a jurisdictional sale. After comparing the situation to *Rayne Field* [4], which deals with a lease-sale, New York says (1) the fields

4. *United Gas Improvement Co.* v. *Continental Oil Company*, 381 U.S. 392 (1965).

here were proven and substantially developed, (2) the royalty owners knew the gas would be sold in interstate commerce, (3) the reserves were known and, (4) the royalty owners had sufficient control to negotiate separate contracts.

In our opinion the kind of transaction here developed between Land Company and Tennessee does not represent a royalty transaction but a sale of natural gas in interstate commerce subject to the jurisdiction of the Commission. This is true although the transaction was closely connected with the lease-sale transaction between Amoco and Tennessee. As noted, the agreement between Land Company and Tennessee was embodied in the letter agreement of July 15, 1960,which was addressed to Amoco and signed by Amoco as well as by Land Company and Tennessee (Ex.42). However, the record shows that the July 15,1960, agreement arose from separate negotiations between Land Company and Tennessee as evinced particularly by Tennessee's letter of March 14, 1960 (Ex. 41). There Tennessee acknowledged that the proposed lease-sale between Amoco and Tennessee could not be carried out without the consent of Land Company. Tennessee then said that "as a practical matter, Tennessee desires either to purchase LL&E's royalty interests or to agree with LL&E upon a permanent royalty settlement basis". Accordingly it made alternative proposals including the arrangement adopted by which the gas received from the leased premises would be valued at a different and higher rate than Tennessee would pay Amoco for the non-royalty gas. The result is that Amoco is selling part of the gas to Tennessee for 21 cents per Mcf while Land Company is receiving 25 cents for another part of the gas. In our opinion the staff and New York are correct that economically this is a sale and it should be treated as such under the Gas Act.

This conclusion, we believe, is consistent with the Court's

opinion in *Mobil*. There the Court said that typically the royalty owner has no control over any incident of the sale of the gas either as to the quantity to be sold, the price to be paid, the identity of the purchaser or whether it shall be sold in interstate or intrastate commerce. The Court added that "an economic interest in the proceeds of a sale, unaccompanied by authority to determine the incidents of the sale, does not make one a seller." (463 F.2d at p. 262).

Here Land Company had expressed concern over the identity of the purchaser and had only agreed to the transaction at a specific price higher than for the lease-sale gas based upon direct negotiations. Also, Land Company, in effect, held the power of approval of whether the gas should be sold in interstate commerce through its control over the assignment of the leases.

The situation here differs from that in the case of the Denman "R" lease, on which the court in *Mobil* made no determination but over which we later denied jurisdiction.[5] There the royalty owner, Denman, insisted that the producer, Huber, have a buyer as requisite to the execution of the lease agreement. But the Commission said that Huber alone selected the purchaser and agreed with him on contract terms, and the contract was entered into solely between Huber and the pipeline. Here the principal royalty holder negotiated directly with the buyer, Tennessee.

REFUND

Having determined that Land Company and Delta have

5. *Denman* v. *Huber Corporation*, 49 FPC 1443, Docket No. RI67-113, June 26, 1973.

been making sales in interstate commerce to Tennessee of their share of the gas from the Bastian Bay Field, the question arises as to whether they are liable for refunds and as to their computation. In the first place, it is clear that if these royalty holders have been receiving more for their gas than they would under the applicable area rate, they should make refunds.[6] To calculate refunds, there must be a comparison between the amounts actually received by the royalty holders and those that would have been received under a conventional contract. Also, the refunds must be calculated on the basis of the applicable area rates in Opinion Nos. 546, 598 and 749 for the various years in which deliveries are made.[7] There are involved controversies about (1) recoverable reserves; (2) the make-up period under an assumed take-or-pay provision; and (3) the application of Opinion No. 598 to certain of the years.

Land Company's witness Mitchell made a computation purporting to show through November 1971,that Land Company actually received $1,733,934 less than if the sale had been conventional. When interest is taken into account, the deficit would rise to $5,304,679.[8] In making these computa-

6. Compare *United Gas Improvement Company* v. *Callery Properties*, 382 U.S. 223 (1965).

7. See *Area Rate Proceeding (Southern Louisiana Area)*, 40 FPC 530, 648 (1968), aff'd *Austral Oil Co.* v. *F.P.C.*, 428 F.2d 407 (CA5-1970), certiorari denied 400 U.S. 1950 (1970); *Area Rate Proceeding (Southern Louisiana Area)*, 46 FPC 86, 145 (1971); aff'd *Mobil Oil Corp. v. F.P.C.* 417 U.S. 283 (1974); *Just and Reasonable National Rates* __FPC __ Opinion No. 749, Docket No. R-478 issued December 31, 1975.

8. Interest through November 1971 in this calculation and in the calculations discussed below increases any deficit and decreases any excess to the royalty holders because under the lease-sale takes of gas were lower in the earlier years than they would have been under a conventional sale and the negative interest in the earlier years is larger than the positive interest in subsequent years.

tions he assumed a net reserve for Land Company of 212,755,000 Mcf and a rate-of-take of 1 Mcf for every 8,000 Mcf of reserves (Tr. 913-918; Exs. 61-63).

The staff's witness Mr. Zenith made a computation under somewhat different assumptions which showed that all of the royalty holders (not just Land Company) in the years 1961 through 1971 received payments of $2,695,931 (or $1,627,502 when interest is taken into consideration) in excess of what they would have received under a conventional contract (Ex. 76, Sch. 4, Tr. 1613). In doing so he postulated net recoverable reserves attributable to the royalty interests of 259,808,874 Mcf (Tr. 1721) as shown by Tennessee (Ex. 64, 70 (Sch. 3)). He also assumed a Daily Contract Quantity (DCO) of 1:8000, a two-year make-up period and prices established by Opinion No. 598 (Tr. 1612-1616). He reduced the excess payments by an amount of $4,637,479 representing gas that Tennessee would have to pay for under a conventional contract, even though the gas could not have been taken within the assumed two-year make-up period. He was thus giving credit for a storage value to the lease-sale gas (Tr. 1618). Since the interest of Land Company and Delta amount to only about 60 percent of the royalty interests in the Bastian Bay Field (Tr. 2094), the staff's excess figure would be reduced to approximately $976,500 for those two royalty owners.

Mr. Mitchell prepared a rebuttal exhibit (Ex. 89) also covering all the royalty gas. He showed excess payment to the royalty holders of only $151, 164 which is reduced to a deficit of $1,761,219 when interest is taken into account. For this purpose he assumed royalty reserves of 272,798,000 Mcf, which he said was 5 percent higher than the reserves used by witness Zenith and was based on data taken from the

fieldwide unitization exhibit prepared by the Bastian Bay Technical Committee, which estimated a reserve 20 percent higher than that estimated by witness Zenith (Tr. 2077-79). Mr. Mitchell also assumed a daily contract volume of 1:8000, a one year make-up period, and gas valued under Opinion No. 598.

On the question of reserves, the staff argues that the Tennessee figure is proper because the parties on entering into the agreement would have relied on a reserve estimate made at that time to determine the DCQ that Tennessee was obliged to take or pay for rather than a subsequent estimate. We agree with the staff on this point.

On the question of the make-up period Mr. Zenith acknowledged that the predominant make-up period in Southern Louisiana contracts of the 1958-1960 period was one year although some contracts provided for make-up periods of 2 or 3 years (Tr. 1612) He thought that if a pipeline intended to use a field for swing purposes, as did Tennessee, it would have tried to negotiate for a longer make-up period. Furthermore, he noted that certificates issued subsequent to May 22, 1961, the date of issuance of a notice of Proposed Rulemaking in Docket No. R-199 were usually conditioned on the outcome of that proceeding which culminated in Order No. 334, 37 FPC 110 (1967) providing for a make-up period of not less than five years. However, he said that if a conventional contract had been executed on July 15, 1960, at the time of the lease-sale, he could not say whether the certificate would have been issued before of after May 22, 1961, but as a matter of judgement he decided to use a two-year make-up period (Tr. 1613). Land Company argues, however, that Amoco would never have agreed to anything less than a

DCQ based on 1:7300 and a one year make-up period. If a one-year make-up period were employed, there would result an excess payment of only $115,571 for the 1961-71 period rather than the amount of $1,617,502 shown by the staff. While these factors are not decisive we find a prevalence of one-year make-up periods at the time of the contract as against our rule the following year providing for a five-year make-up period. Under these circumstances, we are of the opinion that the staff's use of the two year make-up period is reasonable.

On the question of the application of Opinion No. 598 both staff and Land Company would use the refund base prices set forth in the ordering clauses to the Opinion (46 FPC 86,145). However, staff and Land Company differ on the application of Opinion No. 598 to the years 1968, 1969 and 1970. It is there provided that

> "Refunds . . . shall be based upon amounts collected by respondent in excess of the following prices: . . . (c) For deliveries from October 1, 1969, to January 1, 1971, 30.5 percent of the difference between revenues during this period based on rates prior to October 1, 1970, and the revenues resulting during this period through the application of rates established in Opinion Nos. 546[9] and 546-A, as modified by Opinion No. 567."

The 30.5 percent was change to 33 percent by order of November 7, 1972 (48 FPC 980, 983).

9. Opinion No. 546, 40 FPC 530, was the original Southern Louisiana Area case and prescribed a rate of 18.5 cents per Mcf (15.025 psia) for gas sold pursuant to contracts dated before January 1, 1961, and subject to the Louisiana production tax (2.3 cents) (40 FPC at p.648).

In making his computations for the year 1969, for example, Mr. Zenith, before the change to 33 percent, used the lease-sale price of 21 cents per Mcf and deducted 30.5 percent of the difference between that and the Opinion No. 546 price to arrive at an applicable area price of 19.536 cents per Mcf for refund purposes exclusive of the 2.3 production tax (Ex. 76, Sch. 6).[10] The reasoning is that the lease-sale 21 cents (23.3 cents with the production tax) would have been the conventional contract price for the period. The staff contends that the transaction between the royalty owners and Tennessee is an outgrowth of the lease-sale and that the lease-sale price is a good estimate of the rate that would have been set had Land Company and Tennessee executed a conventional contract.

Mr. Mitchell for Land Company used a formula, which appeared to be an alternative, but would produce the same result except that, instead of the lease-sale price of 21 cents, he used 24.818 cents, the royalty price of 25 cents adjusted, to arrive at an applicable area price of 22.189 cents.[11] Mr. Mitchell shows that use of his method for determining the bases of refunds for the years 1968-1970 would result in reducing the staff's excess payment of $1,627,502 (Ex. 76, Sch. 4) to $450,170 for the years 1961-1971 (Tr. 2086; Ex. 89, Sch. 8).

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10. The figure is derived in an exhibit of Amoco's witness Baumunk as follows (Ex. 56):

21 cents - 30.5% (21 cents - 16.2 cents) = 19.536

Here the 21 cents is the lease-sale unit price and 16.2 cents is the Opinion No. 546 area price of 18.5 cents less the production tax.

11. (18.5 - 2.3) + .695 [24.818 - (18.5 - 2.3)] = 22.189 cents.

Land Company argues that the staff disregarded the formula established by Opinion No. 598 which, it says, requires the use of actual revenues in determining the refund rate for the period from October 1, 1968, to January 1, 1971. In our opinion Land Company is right on this point. Opinion No. 598 does provide for refunds of the difference between revenues during this period and revenues under Opinion No. 546 rates (46 FPC at P. 145). In our opinion, revenues under the lease-sale price of 21 cents are irrelevant, even though they may reflect normal prices in the area.

In conclusion, Land Company and Delta are jurisdictional sellers; they should file applications for certificates of public convenience and necessity and rates reflecting levels under Opinion Nos. 546, 598 and 749. However, under the *Mobile-Sierra* rule[12] the rates may not be higher than the contract price of 25 cents plus the Louisiana severance tax. Refunds should be calculated and paid up to the effective date of the new rates. Through 1971, taking interest into consideration, they would be approximately 60 percent (Land Company and Delta interest) of the amount of $450,170 discussed above (Ex. 89, Sch. 8), or $270,102 except that the figure should be adjusted to reflect the 33 percent applicable to the October 1, 1968, to January 1, 1971 period. The refund, of course, would increase since that time, taking into account interest, changes in the area rate, and taxes. We shall therefore require the royalty holders to compute refunds plus interest subject to our approval.

In computing interest it is equitable that the rate be set at 7 percent until October 10, 1974 when Order No. 513 raised

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12. *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *F.P.C. v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

the rate to 9 percent for rate increases in effect subject to refund (52 FPC 920). If the interest rate was equitably 7 percent before that date, it should be 9 percent after that date. Compare *American Public Gas Association et al.* v. *F.P.C.*, ___F.2d___(CADC - May 19, 1976), and Order No. 513-A, issued July 14, 1976.

The Commission further finds:

(1) Land Company and Delta sell natural gas in interstate commerce for resale and are natural gas companies subject to the jurisdiction of the Commission.

(2) The sales made by Land Company and Delta to Tennessee under so-called royalty agreements as described above are sales of natural gas in interstate commerce for resale and are subject to the jurisdiction of the Commission.

(3) Land Company and Delta should file applications for certificates and appropriate rate schedules and should make refunds as provided below.

(4) The other royalty holders do not sell natural gas in interstate commerce and are not natural gas companies subject to the jurisdiction of the commission.

The Commission orders:

(A) Within 120 days of the issuance of this opinion Land Company and Delta shall file applications for certificates of public convenience and necessity for the sale of natural gas from the Bastian Bay Field to Tennessee in accordance with this opinion and order.

(B) Within 120 days of the issuance of this opinion and order Land Company and Delta shall file rate schedules for the sales referred to in (A) above for the period from July 15, 1960 for Land Company and from December 28, 1960, for Delta until the present time reflecting rates that are the lesser of the respective contracts rates or the rates provided by the applicable area rates prescribed by this Commission, all subject to the approval of the Commission.

(C) Within 120 days Land Company and Delta shall file a computation of a refund to be made to Tennessee for the period from July 15, 1960, for Land Company and from December 28, 1960, for Delta until the date the rates prescribed by (B) above go into effect in accordance with this Opinion and Order, subject to the approval of the Commission.

(D) Within 30 days of Commission approval of the amount of refund Land Company and Delta shall make refund to Tennessee of the amount approved by the Commission.

(E) The show cause proceedings in Docket Nos. CI67-1806, CI67-1807, CI67-1808, CI67-1809, CI67-1811, CI67-1812, and CI67-1813 are hereby dismissed.

By the Commission.

(S E A L)

Kenneth F. Plumb,
Secretary.

APPENDIX E
Opinion and Order Denying Rehearing and
Granting Reconsideration

JURISDICTION (Sales),
REFUNDS, ROYALTIES

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Richard L. Dunham, Chairman; Don S. Smith, John H. Holloman III, and James G. Watt.

Delta Development Company, Inc.	)	Docket Nos. CI67-1805
The Louisiana Land and Exploration Company	)	CI67-1810

OPINION NO. 772-A

OPINION AND ORDER DENYING REHEARING
AND GRANTING RECONSIDERATION

(Issued December 13, 1976)

SMITH, Commissioner:

The Louisiana Land and Exploration Company (Land Company) on September 2, 1976, and the Delta Development Co., Inc. (Delta) on September 7, 1976, have filed applications for rehearing with respect to Opinion No. 772 and order issued August 6, 1976.[1] In that opinion the Commis-

1. The Delta application is not timely and must be treated as an application for reconsideration.

sion concluded that transactions between Tennessee Gas Pipeline Company and Land Company and Delta with respect to gas from the Bastian Bay Field do not represent royalty transactions but sales of natural gas in interstate commerce subject to the jurisdiction of the Commission. The Commission required that Land Company and Delta file appropriate applications for certificates of public convenience and necessity for the sale of natural gas from the field to Tennessee and rates that are the lesser of the contract prices or the applicable area rates. Also Land Company and Delta were required to compute and pay a refund to Tennessee based on the difference between revenues received under the purported royalty contracts and those that would have been received under conventional contracts.

Land Company argues that the result reached by Opinion No. 772 was essentially unfair and discriminatory and the procedures were unfair and discriminatory. Land Company contends that Opinion No. 772 has singled out two royalty owners in the Bastian Bay Field and imposed upon them unsought certificates and confiscatory refunds because they agreed to gas royalty payments on a fixed amount per Mcf instead of fluctuating amounts resulting from a "market value" gas royalty clause. It says that the parties who received the benefits of the transaction have them, and Land Company is to suffer penalties for not objecting to the lease transfer.

These two royalty owners participated in a particular transaction with Tennessee by which they received revenue of so much per Mcf for their "royalty" gas delivered to Tennessee as discussed in Opinion No. 772. The Commission found that this made them sellers of gas for resale under

the Natural Gas Act. The Commission found that other royalty holders, the *Fasterlings et al.*, had not executed agreements with Tennessee and dismissed them from the proceedings. We have already determined in this proceeding that the Buras Levee District and the State of Louisiana, which Land Company said consented to the lease-sale and received royalties, are exempt from Commission jurisdiction under Section 2 of the Natural Gas Act [2] regardless of what result we may reach in other cases. [3]

As for the procedure, the Commission agrees that substantial time has elapsed since the proceedings were initiated by a show cause order on June 29, 1967, and the proceedings were complex because they involved the lease-sale transaction between Amoco Production Company [4] and Tennessee, which were settled by an agreement approved on October 24, 1973, in Opinion No. 667. [5] At no point, however, was Land Company denied the right to be heard or to present its position and it has pointed to no such instance. Land Company's chief complaint is that it had to participate in such a proceeding, which it thought unjustified. Since it was and is a natural gas company and has not conformed to the requirements of the Natural Gas Act, its position is not persuasive.

2. See *Tennessee Gas Pipeline Company, et al.*, 37 FPC 1195, 1197 (1967).

3. See *Public Service Company of North Carolina,* Docket No. RP76-103, order of October 5, 1976.

4. "Amoco" including its predecessor, Pan America Petroleum Corporation.

5. *Tennessee Gas Pipeline Company et al.*, 50 FPC 1194 (1973.)

Land Company contends that the findings of the Commission upon which the existence of a sale is based are wholly unsupported. Land Company says the Commission's finding on page 5 that "the record shows that the July 15, 1960, agreement arose from separate negotiations between Land Company and Tennessee as evinced particularly by Tennessee's letter of March 4, 1960 (Ex. 41)" is unsupported. The Commission had before it the letter (Ex. 41) of March 14, 1960, in which Tennessee made alternative offers to Land Company with respect to payments for the royalty gas. It is true that the letter was written in the light of Amoco's negotiations for the transfer of the leases to Tennessee, but the price for the royalty gas was a matter between Land Company and Tennessee. A meeting on this matter was described by Land Company's witness Langhetee as follows (Tr. 375-376):

> "A. At a meeting held on July 12, 1960, although fearful of the problems of "take" and drainage, Land Company offered to agree on the figures presented by Tennessee as a basis for royalty settlement but wished to retain the benefit of the comparative determination of value provided in its leases. Tennessee's representatives stated that they could not accept this because they had to be certain as to the basis for future value determinations. The Tennessee representatives said that if Land Company would agree to their figures, which were those offered as alternative "B" in Tennessee's letter of March 14, 1960, Tennessee would agree unconditionally to make royalty settlements on that basis and that they meant "unconditionally" to mean that

royalty would be paid on the agreed basis whether or not Tennessee would be allowed to recover it as a cost of service. Land Company accepted the offer, although still disturbed over the lack of protection afforded it as to the problems of "take" and drainage. It was agreed that the leases would be amended so as to provide for the computation of our royalties on gas produced on a definite dollar value and that the original provisions would be superseded (i.e., subparagraphs 10, B(i) and (ii))."

Land Company states in its application for rehearing that Land Company met with Amoco and Tennessee on July 12, 1960, but it appears that the transaction was between Land Company and Tennessee regardless of whether Amoco was present and regardless of the fact that the price for the royalty gas was embodied in the agreement of July 15, 1960, which was a letter written by Land Company to Amoco and accepted by Amoco and Tennessee (Ex. 42).

Land Company says that the Commission mis-characterized Tennessee's proposals since, it says, one was cash for the sale of the royalty interest and the second alternative was an agreement fixing a dollar value on which royalties on gas to be produced in the future would be calculated. The second alternative is described in Ex. 41 in part as follows:

"In the event such a Royalty Purchase is not desired, Tennessee offers to enter into an Agreement fixing the value of royalty gas as follows:

1. The value of gas removed from the leased premises would be:

From date of Assignment to January 1, 1962	22.5¢ per Mcf
From January 1, 1962 thereafter	25.0¢ per Mcf"

Whatever the basis of the calculation, it has plainly been reduced to a price per Mcf as in most producer sale contracts.

Land Company considers unfounded the Commission's statement that "Land Company, in effect, held the power of approval of whether the gas should be sold in interstate commerce through its control over the assignment of the leases." Land Company says that its consent was required only because Amoco wished an unusual sale of leases, not gas. And, it says, the record reflects that no such control was sought or exercised. The record is as follows (Tr. 374):

"Q. Did Land Company have an objection to consenting to the sale of the leases by Pan American to Tennessee, and if so, why?

A. Let me put it this way. Our management was fearful that, if we consented to having a pipeline become the lessee under our leases, we would have continual problems of sufficient "take".... So the answer is that Land Company did have objections. At the same time, it did not wish to stand in the way of a deal which its lessee seemed most anxious to make.

Q. How was this dilemma resolved?"

Then follows the quotation set forth earlier. Clearly Land Company did have control. If it did not like the assignment to Tennessee, or the terms of it, it could refuse to give its assent.

On the same subject Delta argues that the record contains no evidence that it elected to take gas in kind or negotiated any sale. It did agree by accepting a letter of December 28, 1960, signed by Tennessee and Amoco that its royalty should be determined, computed and paid as set forth in the Land Company leases as amended by the letter of July 15, 1960. However, there is no evidence that Delta conducted separate negotiations or held any power of approval over whether the gas should be sold in interstate commerce. According to the December 28, 1960, letter Land Company by instrument of February 7, 1938, conveyed a mineral royalty interest to Delta's predecessor, but reserved the right to grant mineral leases covering the lands affected and Amoco was the owner of three such leases granted by Land Company. Therefore, its situation is not the same as that of Land Company. The fact that Delta agreed to a new mode of computing royalties negotiated by other parties does not make it a seller of gas, and it should be dismissed along with the *Fasterlings et al.*, who were dismissed by Opinion No. 772.

Land Company further argues that approval of the lease-sale agreement in Opinion No. 667[6] precludes further proceedings against the royalty owners as a matter of law. It says that the three-party letter agreement of July 15, 1960, (Ex. 42) was an integral part of the transaction and that by

6. *Tennessee Gas Pipeline, et al.*, 50 FPC 1194 (1973).

approving the lease-sale, the Commission placed it beyond its power to void the letter agreement. In Opinion No. 667 the Commission approved a settlement by which it was agreed that Amoco would receive a certificate of public convenience and necessity authorizing the sale of gas under the lease-sale arrangement under certain conditions including the making of a refund. However, it did not approve the letter agreement; it approved a settlement which, in effect, modified the letter agreement; but the issues as to whether Land Company and other royalty owners are selling gas to Tennessee, are subject to the jurisdiction of the Commission, and are liable for refunds were to be treated separately with the severed docket numbers.

Land Company further contends that area rates under Opinion Nos. 546, 598 and 749[7] may not be used as a basis for refunds, for royalty owners were not permitted to participate in such proceedings and if these opinions are construed to apply to royalty owners, they are violative of due process. The Commission used the area rates as a measure of what a producer selling gas in interstate commerce would have received under a conventional contract. Land Company is found here not to be a royalty owner but a seller of gas in interstate commerce and subject to the Commission's jurisdiction.

Land Company also argues that in computing refunds the Commission's reconstruction of a conventional contract is erroneous, is not based on substantial evidence, and, when

7. See *Area Rate Proceeding (Southern Louisiana Area)*, 40 FPC 530, 648 (1968), aff'd *Austral Oil Co. v. F.P.C.*, 428 F.2d 407 (CA5-1970), certiorari denied 400 U.S. 1950 (1970); *Area Rate Proceeding (Southern Louisiana Area)*, 46 FPC 86, 145 (1971); aff'd *Mobil Oil Corp. v. F.P.C.* 417 U.S. 283 (1974); *Just and Reasonable National Rates* __FPC __, Opinion No. 749, Docket No. R-478, issued December 31, 1975.

used as a basis for refunds, amounts to a deprivation of property without due process of law. The Commission explained in Opinion No. 772 that to calculate refunds there must be a comparison between the amounts actually received by the royalty holders and those that would have been received under a conventional contract. The Commission arrived at a refund figure of $270,102 for the years though 1971, subject to a minor upward adjustment and to accruals in later years.

Land Company in the first place objects to the Commission using the staff's calculation of net recoverable reserves attributable to the royalty interests of 259,808,874 Mcf as shown by Tennessee. The staff's argument was that the parties would have relied on a reserve estimate made at the time of the agreement to determine the Daily Contract Quantity (DCQ) that Tennessee was obliged to take or pay for rather than a subsequent estimate. Land Company contends that the reserve figures used were prepared for the hearing, which took place in 1972 (Tr. 703). However, the Tennessee witness there stated that many of the figures are exactly the same as they were in a prior exhibit. This appears to be an exhibit prepared in 1967 by Land Company's Witness Born (Tr. 158) showing the royalty gas underlying Tennessee's acreage as of December 1, 1960, to be 259,003 MMcf, a figure that is almost the same as the later revised amount shown above. Further, applying the percentage of the royalty gas in gross production (See Ex. 64) to the recoverable reserves of 759,550,000 Mcf set forth in the lease-sale agreement as representing the net leasehold interests (Exh. 12, p. 27) results in net recoverable reserves attributable to the royalty interests in the neighborhood of 259,000 MMcf. These figures differ substantially from Land Company's reserve figure of 212,755,000 Mcf (Tr. 915), which

was calculated on the basis of the acre-feet determined by the Bastian Bay Technical Committee. These acre-feet, the witness said, were used as the basis for allocating production among the lessees participating in the Bastian Bay Fieldwide units which became effective in 1969, and were the basis of allocation on which Land Company's royalty payments were determined (Tr. 914). However, it would appear that the earlier figure presented by Tennessee would be closer to what the parties would have contemplated if they had entered into a conventional contract.

Land Company continues to object to the use of a one-year make-up period in computing a refund. As explained in Opinion No. 772, this is a matter of judgment; there was a prevalence of one-year make-up periods at the time of the contract, but a conventional contract could have been influenced by the then current rulemaking proceeding contemplating a five-year make-up period. A longer period would have been important to Tennessee buying gas under a contentional contract for swing purposes.

We agree with Land Company that the computation of a refund invokes estimates and judgment, some of which may substantially affect the result. However, the matter of refunds was considered in a full hearing with a large record and it is necessary to arrive at a result that, considering the interests of producers and consumers, is as equitable as possible.

Land Company says that it is both unable and unwilling to make a sale covered by the Act, but it has shown that it is both willing and able to do the acts and perform the service within the meaning of Section 7(e) of the Act, which are determined here to be jurisdictional. To do these acts and to

perform this service it must have a certificate.

It is the opinion of the Commission that what refunds are made to Tennessee by Land Company should be flowed through by Tennessee to its customers, and we shall so provide.

The Commission further finds:

(1) The assignments of error and grounds for rehearing set forth in Land Company's application for rehearing present no facts or legal principles which would warrant any change in or modification of Opinion No. 772 and order with respect to Land Company as supplemented herein.

(2) The application for reconsideration filed by Delta should be granted, and it should be dismissed from the proceeding.

(3) The refund made by Land Company should be flowed through by Tennessee to its customers.

The Commission orders:

(A) The application for rehearing filed by Land Company is denied.

(B) The application for reconsideration filed by Delta is granted, and Docket No. CI67-1805, is dismissed.

(C) Within 60-days of receiving a refund from Land Company Tennessee shall submit three copies of a plan for the flow-through of the refund applicable to jurisdictional sales,

indicating the amount payable to each jurisdictional customer, the basis used to compute the amount payable and the period involved. Copies of the flow-through plan shall be served on each of Tennessee's jurisdictional customers and upon interested state regulatory commissions.

(D) Upon notification by the Commission Secretary and to the extent directed thereby, Tennessee shall proceed with the distribution of refunds to its jurisdictional customers.

By the Commission.

(S E A L)

APPENDIX F
Natural Gas Act Provisions

Sec. 2. When used in this act, unless the context otherwise requires --

(1) "Person" includes an individual or a corporation.

(2) "Corporation" includes any corporation, joint-stock company, partnership, association, business trust, organized group of persons, whether incorporated or not, receiver or receivers, trustee or trustees of any of the foregoing, but shall not include municipalities as hereinafter defined.

(3) "Municipality" means a city, county, or other political subdivision or agency of a State.

(4) "State" means a State admitted to the Union, the District of Columbia, and any organized Territory of the United States.

(5) "Natural gas" means either natural gas unmixed, or any mixture of natural and artificial gas.

(6) "Natural-gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.

(7) "Interstate commerce" means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States.

(8) "State commission" means the regulatory body of the State or municipality having jurisdiction to regulate rates and charges for the sale of natural gas to consumers within the State or municipality.

(9) "Commission" and "Commissioner" means the Federal Power Commission, and a member thereof, respectively. [52 Stat. 821 (1938); 15 U.S.C. § 717a]

Sec. 7. (c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest. [52 Stat. 825 (1938), as amended, 56 Stat. 83 (1942); 15 U.S.C. §717f (c)]

(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall

be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require. [56 Stat. 84 (1942); 15 U.S.C. § 717f (e)]

Sec. 19 (b) Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure

to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in [former] sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, sec. 1254).

APPENDIX G

Excerpt from "Petition on Behalf of the Louisiana Land and Exploration Company, for Rehearing and Alternative Conditional Application for Leave to Adduce Additional Evidence" Filed June 13, 1978

ALTERNATIVELY AND CONDITIONALLY, LEAVE TO ADDUCE ADDITIONAL EVIDENCE BEFORE THE COMMISSION SHOULD BE GRANTED.

The hearings before the Administrative Law Judge were concluded in 1973. The refund calculations provided for by Opinion No. 772 in 1976 were based on production through the year 1971. The Commission's Opinion assumed (App. 331-332), as did the parties, that refunds so calculated would continue to increase. However, from calculations made in 1978, taking into account production figures through 1977 (not theretofore available), it is now evident that, due to a reversal in delivery volumes, negative "refunds" have occurred.

Using the criteria established by FPC Opinion No. 772, and extending the refund calculations so as to take into account actual production volumes through the year 1977, and the actual amounts received by Land Company as royalties for the same period, there are now no refunds due. To evidence this circumstance, Land Company attaches hereto as Appendix I the affidavit of Joe F. Rhodes III, with an attached exhibit. There is no longer any possibility that a further reversal of production volumes could change the red ink to black. (The area rate now exceeds the "contract" rate.)

Sec. 19(b) of the Natural Gas Act (15 U.S.C. § 717r) provides, in part:

> "If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper."

Hopefully, counsel for FERC and for the New York Commission would stipulate to the calculations contained in Appendix I so as to make the referral unnecessary. However, in the event a stipulation is not forthcoming, Land Company hereby applies to the Court, pursuant to said Sec. 19(b), for leave to adduce such additional evidence, showing to the Court that such evidence is necessarily material and was obviously not available at the time of Commission action, nor at the time of the submission of this case on review.

APPENDIX H

(Excerpts from Testimony of A.E. Renfro, Witness for Amoco Production Company, on Cross-examination by Counsel for the Staff of the Federal Power Commission)

(App. Ct. App. 77):

"Q Was LL&E a part of those discussions for the sale of the reserves when it did involve a lease sale?

A If I understand your question, did LL&E participate in our agreeing with Tennessee to make a lease sale? Is that your question?

Q Yes.

A The answer is no."

(App. Ct. App. 78):

"Q Now, did anybody from LL&E or anybody representing LL&E offer any advice to you or anybody on Pan Am's staff concerning the lease sale?

A Advice in what respect?

Q As to their preferences concerning the type of lease sale or who would purchase the gas, or the terms of the lease sale agreement.

A No."

(App. Ct. App. 79):

"Q And to your knowledge did the fact you you needed LL&E's or Delta Development Company's consent to transfer the leases affect in any way any of the terms of the lease sale contract?

A No, sir. Except that we had to recite that as one of the conditions of the sale."

No. 78-687

In the Supreme Court of the United States

OCTOBER TERM, 1978

LOUISIANA LAND AND EXPLORATION COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-9a) is reported at 574 F.2d 204. The opinion denying rehearing (Pet. App. 10a) is reported at 579 F.2d 971. The initial opinion and order (No. 772) of the Federal Power Commission (Pet. App. 13a-27a) and its opinion and order (No. 772-A) denying rehearing (Pet. App. 28a-39a) are not yet reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 11a-12a) was entered on May 30, 1978, and its order denying rehearing (Pet. App. 10a) was entered on September 11, 1978. The petition for a writ of certiorari was filed on October 24, 1978. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether the Federal Power Commission erred in determining that petitioner had made a sale of natural gas in interstate commerce within the jurisdiction of the Commission under Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b).

STATEMENT

In 1955 and 1959, petitioner, the owner of lands in what later became known as the Bastian Bay Field, Louisiana, executed oil and gas leases with a predecessor of Amoco Production Company (collectively referred to as "Amoco"). The leases provided for the payment of royalties to petitioner measured by a percentage (27½% or 30%) of the price at which the lessee sold the gas to third parties. The leases alternatively provided that if the lessee used the gas itself or sold it to an affiliate, the royalties would be the same percentage of the "fair and reasonable value" of the gas (Pet. App. 15a). The leases required petitioner's written consent prior to any assignment, sublease, or other transfer of the leaseholds (Pet. App. 2a, 15a).

Amoco's drilling on its leaseholds confirmed the existence of substantial natural gas reserves (Pet. 4). Instead of selling the gas under a conventional contract, Amoco arranged to assign its leasehold interests to Tennessee Gas Pipeline Company ("Tennessee"), an interstate carrier, at a price equivalent to 21 cents per Mcf of the estimated leasehold reserves (Pet. App. 15a-16a, 18a; see also *Pan American Petroleum Corp.* v. *FPC*, 339 F.2d 694, 695 (10th Cir. 1964), reversed, 381 U.S. 762 (1965)). The Amoco-Tennessee transfer was later found by this Court to have been a "sale" in place of proven natural gas reserves within the meaning of Section 1(b) of the Act and thus subject to the Commission's jurisdiction. *FPC* v. *Pan American Petroleum Corp.*, 381 U.S. 762 (1965). The Court relied on its decision a week earlier in the *Rayne Field* case, *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965). In *Rayne Field*, the Court held that if the economic effect of a transfer is similar to that of a conventional sale, if the subject of the transaction is proven and substantially developed reserves, and if the transfer of the reserves is for the purpose of interstate transmission and resale, the transaction is a "sale" within the meaning of Section 1(b) of the Act. *Id.* at 401.

After Amoco and Tennessee had agreed on the assignment of the leases to Tennessee, Tennessee approached petitioner and offered to purchase petitioner's royalty interest in the leases or, alternatively, to amend the leases to provide that royalty payments be calculated as a percentage of a fixed value for gas

removed from the leaseholds (22.5 cents per Mcf through January 1, 1962, and 25 cents per Mcf thereafter) instead of a percentage of a varying market price (Pet. App. 2a, 33a). Petitioner accepted the offer of fixed-rate royalties, and its acceptance was embodied in a letter contract signed by petitioner, Amoco, and Tennessee. Petitioner thereupon consented to the Amoco-Tennessee assignment (Pet. App. 16a).

The Commission held that petitioner's participation in the lease assignment and renegotiation of royalties constituted the "sale of natural gas in interstate commerce subject to the jurisdiction of the Commission" (Pet. App. 18a). The Commission reasoned that the effect of the transaction was that (*ibid.*):

> Amoco is selling part of the gas to Tennessee for 21 cents per Mcf while [petitioner] is receiving 25 cents for another part of the gas. In our opinion * * * this is a sale and it should be treated as such under the Gas Act.

Accordingly, the Commission determined that petitioner should refund the amount by which its renegotiated royalties exceeded the maximum rates that would have been permissible under a conventional, regulated gas sales contract (Pet. App. 19a-25a).

The court of appeals affirmed (Pet. App. 1a-9a). The court applied this Court's *Rayne Field* test and held (Pet. App. 6a) that petitioner's retained power to withhold consent to the lease transfers,

> coupled as it was with an alteration of the royalty rate, had the effect of altering not only the cost of extracting the gas but also the cost of introducing the gas to commerce. Under these circumstances, we conclude that in economic effect [petitioner] sold gas in interstate commerce subject to FERC jurisdiction.

The court also found the Commission's refund calculation to be supported by substantial evidence (Pet. App. 9a).

In a petition for rehearing, petitioner for the first time argued that if the Commission's refund formula was applied to the production history of the leaseholds and to the royalty payments made in the years since the administrative record was closed, no refunds would now be due. Accordingly, petitioner asked the court for leave to adduce additional evidence before the Commission pursuant to Section 19(b) of the Act, 15 U.S.C. 717r(b) (Pet. App. 45a-46a).

The court denied rehearing, but stated: "[t]he Commission should, however, allow additional hearing on whether refunds should be recalculated * * *" (Pet. App. 10a).[1]

ARGUMENT

The decision below is correct, there is no conflict among the circuits, and the issue presented by the unique facts of this case is not of general or recurring importance.

1. The Commission and the court of appeals correctly applied the principles established in *Rayne Field, supra*, in determining that petitioner's trans-

[1] No application for such a hearing has yet been filed with the Commission.

action with Tennessee was in effect a sale of natural gas in interstate commerce and therefore within the Commission's jurisdiction under Section 1(b) of the Natural Gas Act.

Petitioner's claim (Pet. 10-18) that it entered into an ordinary lease and royalty agreement with Tennessee is incorrect. The substance of the various transactions was as follows: Under the original leases, Amoco, as lessee, had a right to produce and sell gas from the leaseholds and was required to pay royalties to petitioner of 27.5% or 30% of Amoco's selling price. Amoco wished to assign all its rights to the gas to Tennessee at a price equivalent to 21 cents per Mcf—an assignment this Court later held to be a jurisdictional sale, *FPC* v. *Pan American Petroleum Corp., supra*. Amoco and Tennessee, however, needed petitioner's consent to the assignment. Petitioner consented to the assignment after renegotiating the royalty provisions to provide petitioner with royalties calculated on the basis of a fixed value for the gas. As the Commission held (Pet. App. 18a), fixing the value of the gas for royalty purposes at 25 cents per Mcf (after January 1, 1962) amounted to a sale of the gas attributable to petitioner's royalty interest—at a price, indeed, higher than the price at which Amoco sold its interest in the gas to Tennessee.[2] In short, the Commission and the court of appeals correctly determined that under this Court's opinion in *Rayne Field*, the economic effect of petitioner's transaction with Tennessee was a jurisdictional sale of gas.[3]

Indeed, petitioner appears to recognize that the Commission correctly applied *Rayne Field*, since it argues that *Rayne Field* was wrongly decided and that "this Court should consider reshaping its holding * * *" (Pet. 13 & n.18). There is no occasion, however, to reconsider *Rayne Field*, which this Court has cited with approval several times, most recently in *California* v. *Southland Royalty Co.*, 436 U.S. 519, 541 (1978).[4]

[2] The economic effect of the transactions is the same as if Amoco and petitioner had divided the gas under the leaseholds between them (27.5% and 30% to petitioner and 72.5% and 70% to Amoco), Amoco had sold its portion to Tennessee for 21 cents per Mcf, and petitioner had sold its portion to Tennessee for 25 cents per Mcf.

[3] Petitioner argues (Pet. 14-18) that the record does not support the Commission's conclusion that petitioner's right to withhold consent to the assignment of the lease to Tennessee was relevant to the terms of the final arrangement between petitioner and Tennessee. The record evidence cited by the Commission belies petitioner's apparent contention that it did not negotiate with Tennessee and did no more than passively consent to Tennessee's proposal (see Pet. App. 31a-34a). But even if there had been no evidence concerning the actual negotiations between petitioner and Tennessee, the Commission would have been justified in concluding that petitioner's right to withhold consent to the assignment was a significant factor leading to the renegotiation of the royalties, and that if the original leases had not given petitioner that right, Tennessee, as assignee, would have been content with the original royalty provisions.

[4] Moreover, the Natural Gas Policy Act of 1978, Pub. L. No. 95-621, enacted November 9, 1978, 92 Stat. 3350, codifies the *Rayne Field* doctrine. That Act defines "sale" to mean "any sale, exchange, or transfer for value" (Section 2(20)), and defines "deliver," with respect to any first sale of natural gas, to include "in the case of the sale of proven reserves in place * * * the transfer of title to such reserves." Section 2(22).

2. Contrary to petitioner's claim (Pet. 9-12), the court of appeals' holding is fully consistent with *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1971), cert. denied, 406 U.S. 976 (1972). In *Mobil*, the court of appeals held that by executing a typical oil and gas lease, a landowner does not make a "sale" of natural gas subject to Commission jurisdiction. As the court stated (463 F.2d at 262; footnote omitted), the lessor of reserves normally has

> no knowledge when the lease is executed of the ultimate destination of any gas that might be discovered, no knowledge whether the gas, if discovered, will be sold either to an interstate pipeline or to any other customer that will move it across state lines. While the lease by the landowner provides for a royalty in the event of the discovery and sale of gas, typically he has no control over any incident of such sale either as to the quantity to be sold, the price to be paid, the identity of the purchaser or whether it shall be sold in interstate or intrastate commerce.

The transaction in this case is not the typical lease transaction described in *Mobil*. Here, proven and substantially developed reserves were the subject of the transfer; the transfer itself was for the purpose of interstate transmission and resale. Petitioner stepped out of the role of the typical royalty owner to affect the incidents of the sale, most particularly the cost of the gas on which the royalty was based. These facts distinguish petitioner from the typical lessor

considered in *Mobil*, as the court of appeals here recognized (Pet. App. 5a-6a).

3. Petitioner also contends (Pet. 18-20) that the court of appeals erred in denying petitioner's motion for leave to adduce additional evidence before the Commission. The proffered evidence relates to gas production and royalty payments in the years since the administrative record was closed; according to petitioner, the new evidence, when the Commission's refund formula is applied to it, would eliminate any refund obligation.

The new evidence proffered does not affect the merits of the Commission's holding, and the proffer implicitly accepts the Commission's methodology for computing refunds. Because the evidence did not controvert the Commission's fundamental conclusions, the court of appeals properly denied the motion. Cf. *FPC* v. *Transcontinental Gas Pipe Line Corp.*, 423 U.S. 326, 331 (1976). In any event, petitioner is now free to present its new evidence to the Commission, by virtue of the court of appeals' direction on petition for rehearing that "[t]he Commission should * * * allow additional hearing on whether refunds should be recalculated * * *" (Pet. App. 10a). Any decision by the Commission on an application to recalculate refunds will be subject to judicial review. Because petitioner has available a complete remedy, there is no reason for further review here.

4. Finally, the events giving rise to this proceeding are unlikely to recur. The lease-sale transaction consummated by Amoco and Tennessee in this case is

similar to other lease-transfer arrangements devised by producers following this Court's decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), in attempting to avoid rate regulation under the Natural Gas Act. Following this Court's holding in *Rayne Field*, the impetus for improvising such transactions evaporated; if the transaction in question "accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States," then that "is the significant and determinative economic fact." 381 U.S. at 401.

Moreover, petitioner's role as a royalty owner in the Amoco-Tennessee transfer appears to be unique. Eight of the nine royalty owners that were parties to the Commission proceeding, for example, did not negotiate separate royalty agreements with Tennessee and were dismissed from the proceeding (Pet. App. 16a, 34a). In no other case subsequent to the decision in *Mobil*, *supra*, has the Commission been presented with facts similar to those presented here. There is, therefore, no reason to believe that the issues raised in this case are of general importance or recurring significance.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1979

☆ U. S. GOVERNMENT PRINTING OFFICE: 1978 284165 256

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

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Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION
and
THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,

Respondents.

MEMORANDUM BRIEF OF THE RESPONDENT PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK IN OPPOSITION TO PETITION FOR CERTIORARI

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November 24, 1978

DI CESARE · Printing — 331-8101 — Washington, D.C. 20006

CITATIONS

ADMINISTRATIVE DECISIONS:

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Respondents.

MEMORANDUM BRIEF OF THE RESPONDENT PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK IN OPPOSITION TO PETITION FOR CERTIORARI

The Public Service Commission of the State of New York (New York) herewith opposes the petition for certiorari filed in this case by Louisiana Land and Exploration Company (LL&E) seeking review of the opinion of the Fifth Circuit Court of Appeals in Case No. 76-4380, issued on May 30, 1978, 574 F.2d 204 (Pet. App. 1a-9a) affirming Opinion Nos. 772 and 772-A of the Federal Power Commission (Pet. App. 13a-39a). Certiorari should be denied because the Commission

and court below reached clearly sound decisions on a unique factual issue which is not likely to be repeated in the future.

1. This case is an outgrowth of the "lease sale" device adopted by a number of natural gas producers in the late-1950's in an unsuccessful effort to evade price regulation under the Natural Gas Act, subsequent to this Court's decision in *Phillips Petroleum Corporation* v. *Wisconsin,* 347 U.S. 672 (1954), holding that producer sales were covered by the Act. The effort failed when this court held lease sales to be sales of natural gas (*United Gas Improvement Co.* v. *Continental Oil Co.,* 381 U.S. 392 (1965) and the Commission on remand subsequently concluded that lease sale arrangements were contrary to the public interest and would not be authorized. *See, Texas Eastern Transmission Corp.,* 44 F.P.C. 1079 (1970), affirmed on this point, *Public Service Commission of the State of New York* v. *Federal Power Commission,* 543 F.2d 757; 830 (1974 and 1975), *cert. denied sub nom., Sun Oil Co.* v. *Public Service Commission,* 424 U.S. 910 (1976).

The present case arose out of a 1960 lease sale of developed gas production acreage in the Bastian Bay area of Southern Louisiana to Tennessee Gas Transmission Company. The transaction, which was held to involve a jurisdictional sale in *Tennessee Gas Transmission Co.,* 30 F.P.C. 1477 (1963), affirmed, *Federal Power Commission* v. *Pan American Petroleum Corp.,* 381 U.S. 762 (1965), differed from the other lease sale proposals coming before the Commission in that LL&E, a lessor of some of the property being conveyed, exercised its contract rights to approve any lease assignment only upon the condition that the pipeline purchaser, Tennessee, agree to pay it a specified

amount per Mcf for its share of all gas produced from the field. This amount, 22.5 cents per Mcf until January 1, 1962 and 25.0 cents per Mcf thereafter (Pet. App. 15a) was significantly higher than the per Mcf revenues which would be secured by the producers at the then estimated reserve levels in the Bastian Bay Field (Pet. App. 18a).

To the best of our knowledge, this situation in which a lessor separately contracts with a pipeline for the revenues to be secured for its royalty interest in a lease and does so at an effective rate per Mcf higher both than that secured by the lessee producer and the level determined as just and reasonable by the Commission under the Natural Gas Act, is unique to the present transaction. It certainly was not typical of any significant number of gas sales transactions.

The Commission's determinations in Opinion No. 772 (Pet. App. 13a-27a) and Opinion No. 772-A (Pet. App. 28a-39a), that the lessor's actions in these circumstances constituted a "sale" within the meaning of *United Gas Improvement Co., supra,* and *Mobil Oil Corp.* v. *Federal Power Commission,* 463 F.2d 256 (D.C. Cir. 1971), *cert. denied,* 406 U.S. 976 (1972) is in our opinion clearly correct as a matter of fact and law. To the very large extent, however, that the petition challenges the Commission's construction of the facts, as affirmed by the court of appeals, this is obviously not a matter for this Court's plenary review. *See, e.g., Mobil Oil Corp.* v. *Federal Power,* 417 U.S. 283, 307-310 (1974).

The basic legal question decided by the Court below—whether a separate arrangement between a royalty owner and a pipeline specifying the level of the payment to be made for the royalty interest in the gas on a basis different from that provided for in the pipeline's contract for the lessee's interest can be classified as a

"sale" within the meaning of the Natural Gas Act—is, we are convinced not subject to serious dispute. This Court's opinion in the *United Gas Improvement Co.* case, *supra,* makes clear that the economic realities rather than categorization under state law determines whether a transaction is a sale subject to the jurisdiction of the Commission. *See also, California* v. *LoVaca Gas Gathering Co.,* 379 U.S. 366 (1965). *Mobil Oil Corp.* v. *Federal Power Commission,* 463 F.2d 256 (D.C. Cir. 1971), *cert. denied,* 406 U.S. 976 (1972) upon which petitioner places its principal reliance does not carve out an exception for royalty interests. For while the court of appeals in *Mobil* held that a royal contract does not constitute a sale of gas in interstate commerce where the lessor performs no significant role in the sale transaction, it made clear that the determinative issue was whether the "economic impact" of a transaction between the royalty holder and the purchasing pipeline constituted, "the equivalent of conventional sales of natural gas." It stressed that in the standard royalty situation, to which the Commission's order under review was directed, the lessor normally has

> . . . no knowledge when the lease is executed of the ultimate destination of any gas that might be discovered, no knowledge whether the gas, if discovered, will be either to an interstate pipeline or to any other customer that will move it across state lines . . . [and] typically has no control over any incident of such sale either as to the quantity to be sold, the price to be paid, the identity of the purchaser. . . .
> (*Mobile Oil Corp.* v. *Federal Power Commission, Supra,* 463 F.2d at 262.)

A determination that "an economic interest in the proceeds of a sale, unaccompanied by authority to

determine the incidents of the sale, does not make one a seller" (*Ibid.*), clearly does not cover this case. On the contrary, the Court's action with respect to the so-called Denman "R" line (463 F.2d at 266), clearly indicates its belief that circumstances might exist where a royalty owner's actions could be construed as constituting a sale under the Natural Gas Act.[1]

2. The present case has no general significance in the administration of the Natural Gas Act, or the newly enacted Natural Gas Policy Act of 1978, Public Law No. 95-621, H.R. 5289, signed by the President November 9, 1978. Not only is the factual situation presented virtually unique in the forty year history of the Natural Gas Act, but the chances for it arising in the future are virtually nil. The Federal Power Commission has found that lease sales of the type which led to petitioners' determination to contract directly with the pipeline purchaser are contrary to the public interest and none have been submitted for certification in the last decade. In addition, the recent passage of the Natural Gas Policy Act of 1978, by prescribing legislatively the maximum rates at which all new sales—both interstate and intrastate—can be made, and providing for ultimate deregulation of all new sales of natural gas, would appear to have eliminated the underlying cause for controversy or disagreement between lessor and lessee as to the appropriate rate and terms for sales of any gas produced from the lease which could lead a

[1] As the Commission made clear (Pet. App. 19a), the subsequent *Denman* case at the Commission (*Denman* v. *Huber Corp.,* 49 F.P.C. 1443 (1973)), relied upon by petitioner, is far removed in fact from the present case since the lessee in the Denman case alone selected the purchaser and agreed with him on contract terms governing payment for all of the gas. This is quite different from the situation here where the petitioner not only negotiated directly with the pipeline purchaser but arranged for a more favorable deal for its royalty interest than the producers secured.

lessor to seek a separate arrangement with the purchaser of the gas.

It would be premature, in view of the newness and complexity of the new Act, to conclude that no significant issue as to the relationship of royalty contracts or actions by lessors independent of the lessees can or will develop in the future—though if one does arise there is no reason to believe it will resemble the present case. But certainly there is nothing to indicate that review of the lower court decision here will have any general significance which could warrant granting the writ—even if the Court were to have greater doubts as to the correctness of the decision below than we believe is conceivably warranted. Accordingly, New York believes the petition for a writ of the certiorari must be denied.

Respectfully submitted,

THE PUBLIC SERVICE COMMISSION
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November 24, 1978

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-687

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REPLY BRIEF OF PETITIONER TO BRIEFS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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Respondents.

REPLY BRIEF OF PETITIONER TO BRIEFS IN OPPOSITION

The Federal Energy Regulatory Commission ("the Commission") and The Public Service Commission of the State of New York ("New York") have filed briefs in opposition to the petition of The Louisiana Land and Exploration Company ("Land Company") for certiorari. This reply brief is filed pursuant to Rule 24 (4) of this Court.

1. The Commission (Brief, pp. 9-10) and New York (Brief, pp. 5-6) argue that this case is not of sufficient importance to warrant certiorari, basing their argument on the *non sequitur* that no lease-sale is likely again to

occur. The statement is true; the conclusion drawn is fallacious. The recurring items are (a) requests for approval of assignments of leases to pipeline companies and (b) requests for "pegging" market value royalties. In the shadow of the ruling of the court of appeals no lessor will willingly accede to any such request.

2. The Commission, being unable to find record support for the innuendo of the court of appeals that Land Company "demanded" a "higher" royalty settlement as the price of consenting to a sublease, resorts to citing the Commission's own opinion (as found in Pet. App. 31a-34a). The quotation does not support the statement.

The record is uncontradicted—there is *no* evidence to the contrary—that Land Company did not wish to change its royalty provisions and that it was only at Tennessee's insistence that the market value was "pegged."

The court of appeals and the Commission each drew an entirely permissible inference that if Land Company had not wished to consent to the sublease it could have withheld its consent. But then they each drew an entirely impermissible and unsubstantiated "inference" that because Land Company "could" have withheld its consent, it *did* withhold its consent until it had received a "higher" basis of royalty settlement. If there had been any evidence in the record to support this inference, the Commission or the court of appeals would have cited it, by book and page, long ere this.

3. Contrary to the Commission's statement (Brief, p. 7), the Natural Gas Policy Act of 1978, P.L. 95-621, 92 Stat. 3350, does *not* codify *Rayne Field (United Gas Improvement Co.* v. *Continental Oil Co.,* 381 U.S. 392

(1965). On the contrary it substitutes a reasonably precise statutory jurisdictional definition for *Rayne Field's* Delphic metamorphology.

In any event, the new Act neither adds to nor detracts from the importance of the questions here presented, nor does it point to the direction of decision.

4. Concerning Land Company's proferred evidence, the Commission says that it "does not affect the merits of the Commission's holding. . ." (Brief, p. 9). Apparently, the Commission draws no distinction between a refund order which is supported by the record and one which is in the teeth of the evidence. Also, the Commission forgets that Land Company was supposed to have demanded "higher" royalties, while the proferred evidence shows that the royalties were "lower."

CONCLUSION

For the reasons set forth in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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